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C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 001151

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DOE FOR GEORGE PERSON

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TAGS: [EPET](#) [ENRG](#) [PGOV](#) [EINV](#) [PINR](#) [IZ](#)
SUBJECT: MINISTRY OF OIL UPDATE ON BID ROUNDS, OIL
PRODUCTION, AND SHELL FLARED GAS DEAL

Classified By: DOE Energy Attache Edgar Parks, reasons 1.4(b,d)

¶1. (C) Summary: Two Ministry of Oil (MoO) Directors General provided details of internal MoO deliberations regarding progress on the two bid rounds and the MoO's crude oil production in separate April 23 meetings with DOE Energy officers, followed up by another meeting between Energy Attache and one DG on April 28. During an April 21 internal MoO meeting, Oil Minister Shahrستاني rejected his subordinates' recommendation to abandon the first bid round (inviting tenders on six producing oil fields and two gas fields) and took no decision on the corporate income tax rate to be levied on the winning companies. Average daily oil production continues to decline. The April 28 meeting also focused on the remaining issues to be resolved in forming a joint venture between Shell and South Gas Company to process associated gas currently being flared from Iraq's southern oil fields. End summary.

Staff Meeting Issues

¶2. (C) The DGs said during the April 23 meeting that Oil Minister Shahrستاني held an inconclusive meeting two days previous with key Directors General and other staff to decide remaining issues and finalize MoO's first bid round's model contract. Shahrستاني rejected a proposal to scrap the first bid round due to certain remaining unresolved issues and focus instead on developing the fields contained in the second bid round. Moreover, Shahrستاني is virtually alone (of MoO's upper management) in believing that the first bid round contracts will not require COR approval. During the subsequent April 28 meeting, the DG said the Petroleum Contracting and Licensing Directorate had issued a letter the day prior detailing the resolution of the remaining model contract issues. Nonetheless, our contact did not believe the issues had actually been resolved within MoO.

¶3. (C) MoO has determined that it will receive \$2.6 billion from signature bonuses from the winning bids on the eight Fields in the first bid round. The winning international oil companies (IOCs) must also provide a cumulative \$1.5 billion in performance bonds. The MoO has not yet decided whether the IOCs' income tax rate will be 15% or 35% of net income. During MoO's April 21 internal staff meeting Shahrستاني and others raised concerns about the work and competence of the contractor, Gaffney, Kline, and Associates, the consultant assisting MoO in implementing the bid rounds, but no decision was taken on replacing the firm. (The next internal staff meeting is May 4.)

Production Problems

¶4. (C) The MoO officials also said the MoO's Southern Fields Committee has taken no action to implement the "crash program" to produce additional oil (initiated in December

under DPM Salih) until it receives written authorization from the PM, or the Cabinet through Minister Shahrishyani. The new Deputy Minister for Upstream (DM), Abdul Kareem Luaibi, heads the Fields Committee. The PM-chaired Energy Policy Committee formed after the late February Oil Policy Symposium has not had its initial meeting yet. Meanwhile, the MoO's upstream companies, Maysan and the South and North Oil Companies, issued their respective 1st quarter 2009 reports showing a current production of 1.65 million barrels per day (b/d) in Basrah, some 600,000 b/d under the 2009 Plan established in late 2007 of 2.25 million b/d.

15. (C) One of the officials said on April 23 that the trend of average daily oil production continues to decline, with a Qof average daily oil production continues to decline, with a loss of 100-150,000 b/d from the southern fields now compared to the end of 2008. Of Iraq's 1,470 current oil wells (including some used for water injection), 523 are producing oil, and about 950 need to be repaired, recompleted, or replaced. The MoO's Studies Directorate believes that, by re-perforating and recompleting between 300 to 500 (of the 950 non-working wells), Iraq could produce an additional 300,000 to 500,000 b/d of crude oil this year under the "crash program."

The Shell Flared Gas Deal

16. (C) On April 21, a DG said Shell has written MoO about whether the contract for the Natural Gas Project currently under negotiation with Shell legally required COR approval in light of Law 97 of 1967. The MoO Legal Directorate DG told Emboff earlier that Law 97 (applicable to upstream

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activities) is not relevant to Shell's downstream gas project. Shell estimates it will install \$12 billion in new plant facilities for this Project.

17. (SBU) On April 28, the MOO DG identified several important issues under current contract discussions with Shell regarding the Southern Gas (Flare Reduction) Project. The issues include:

- The parties' successful negotiation of: the Shareholder Agreement (with each side's capital contributions and rights spelled out, including ownership or lease of real estate and installed plant throughout the 25-year term of the project's contract, as well as thereafter);
- Gas Purchase Agreement with South Gas Company (regarding Shell's payment for natural gas consumed);
- Gas Products Agreement (for Shell's processing of gas into products (e.g., LPG, etc) for MOO's disposition/sale);
- Supply Agreement (in which Shell or the MoO provides gas to Ministry of Electricity for power generation); and
- Agreement on an economic model to be used for the Project.

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